

Message Text

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ACTION INR-07

INFO OCT-01 EUR-12 EA-07 IO-11 ISO-00 SP-02 USIA-06 AID-05

EB-07 NSC-05 CIEP-01 TRSE-00 SS-15 STR-04 OMB-01

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R 130803Z MAR 76

FM AMEMBASSY WARSAW

TO SECSTATE WASHDC 230

INFO AMEMBASSY BERLIN

AMEMBASSY BERN

AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY BUCHAREST

AMEMBASSY BUDAPEST

AMEMBASSY HELSINKI

AMEMBASSY LONDON

AMEMBASSY MOSCOW

AMEMBASSY OTTAWA

AMEMBASSY PARIS

AMEMBASSY PRAGUE

AMEMBASSY ROME

AMEMBASSY SOFIA

AMEMBASSY STOCKHOLM

AMEMBASSY THE HAGUE

AMEMBASSY TOKYO

AMEMBASSY VIENNA

USMISSION GENEVA

USMISSION NATO

AMCONSUL KRAKOW

AMCONSUL POZNAN

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E.O. 11652: GDS

TAGS: EEWT, EFIN, EINV, ETRAD, XG, XT, PL
SUBJECT: FINANCING EASTERN EUROPE'S TRADE WITH THE WEST

REF STATE 038308

1. SUMMARY: MEETING THEIR COUNTRY'S LARGE DEBT-SERVICE PAYMENTS TO WESTERN CREDITORS IS A MAJOR CONCERN OF POLAND'S LEADERS AND WILL REMAIN SO FOR AT LEAST ANOTHER YEAR. THESE LEADERS ARE AWARE THAT PRESERVING A GOOD REPUTATION FOR PAYING DEBTS IS CRUCIAL TO EXPANDING OR EVEN CONTINUING THE COUNTRY'S ECONOMICALLY AND POLITICALLY IMPORTANT TIES WITH WESTERN ECONOMIES. IN DEALING WITH ITS DEBT-SERVICING PROBLEM, POLAND HAS BEEN FORCED TO TAKE MANY STEPS WHICH ARE INTEGRATING ITS ECONOMY MORE FULLY WITH THE WEST.

2. MUCH OF POLAND'S DEBT-SERVICING PROBLEM RESULTS FROM THE RADICAL CHANGES WHICH HAVE OCCURRED IN WESTERN ECONOMIES AND FINANCIAL MARKETS IN RECENT YEARS. POLAND IS A VERY GOOD LONG-TERM CREDIT RISK, AND, GIVEN A RECOVERY IN WESTERN ECONOMIES AND STABILITY IN THEIR CREDIT MARKETS, THE CURRENT CREDIT CRUNCH SHOULD PROVE TEMPORARY. END SUMMARY.

3. SOMEWHAT TO HIS SURPRISE, THE POLISH GOVERNMENT HAS HAD INCREASING DIFFICULTY IN RECENT MONTHS IN DEALING WITH ITS LARGE AND GROWING DEBT-SERVICING BURDEN. WHEN IT EMBARKED ON ITS LARGE-SCALE BORROWING CAMPAIGN IN THE WEST FOLLOWING GIEREK'S RISE TO POWER, POLAND ENCOUNTERED AN INTERNATIONAL BANKING COMMUNITY WHICH PRESSED MONEY ON IT AT EXTREMELY LOW RATES. THE RADICAL CHANGE OVER THE LAST TWO YEARS IN THE INTERNATIONAL BANKING CLIMATE AND IN THE BANKS' ATTITUDE TOWARD POLAND APPARENTLY TOOK SOME GOVERNMENT OFFICIALS BY SURPRISE. THE PERIOD OF SURPRISE IS OVER, AND POLISH OFFICIALS ARE NOW HARD AT WORK TRYING TO DEAL WITH A DIFFICULT SITUATION. UNDERSTANDABLY, THEY DO NOT ADMIT THAT THEY HAVE A PROBLEM, BUT THEIR ACTIONS BETRAY SOME CONSIDERABLE CONCERN.

4. PRECISE DATA ON POLAND'S HARD-CURRENCY DEBT AND DEBT-SERVICING OBLIGATIONS ARE NOT AS AVAILABLE AS THEY WOULD BE IN WESTERN COUNTRIES, BUT A CLEARER PICTURE IS CONFIDENTIAL

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EMERGING AS POLAND HAS RELEASED INCREASING AMOUNTS OF FINANCIAL DATA IN ORDER TO ASSUAGE THE GROWING CONCERNS OF WESTERN CREDITORS. INFORMED ESTIMATES PLACE THE POLISH HARD-CURRENCY DEBT AT ABOUT \$7.5-BILLION DOLLARS AT THE END OF 1975, AND ITS 1976 INTEREST AND PRINCIPAL PAYMENTS ON THIS DEBT ARE ESTIMATED TO BE ABOUT \$1.5-BILLION. IT IS ALSO ESTIMATED THAT THE DEBT-SERVICE BURDEN WILL RISE DURING THE NEXT SEVERAL YEARS AS GRACE PERIODS EXPIRE ON

PREVIOUS LOANS.

5. DESPITE THE LARGE HARD-CURRENCY DEBT WHICH IT HAS ACCUMULATED, WESTERN EXPORTER CREDITS FOR MAJOR PROJECTS ARE STILL READILY AVAILABLE TO POLAND. WE ESTIMATE THAT \$3 TO \$4 BILLION IN EXPORTER CREDITS ARE AVAILABLE RIGHT NOW FOR INVESTMENT PROJECTS. IT IS PROVING MORE DIFFICULT TO OBTAIN FINANCIAL CREDITS, WHICH ARE NOT TIED TO SPECIFIC IMPORTS AND THUS CAN BE USED FREELY TO MEET DEBT-SERVICE CHARGES.

6. SUCH FINANCIAL CREDITS HAVE BECOME VERY DIFFICULT FOR POLAND TO SECURE, LARGELY BECAUSE U.S. AND EUROPEAN BANKS GREATLY TIGHTENED THEIR LENDING PRACTICES FOLLOWING THE FRANKLIN AND HERSTATT BANK FAILURES, BUT ALSO BECAUSE POLAND'S GROWING INDEBTEDNESS IS WORRYING INTERNATIONAL BANKERS. THE PRIVATE BANKERS WHO SUPPLY THE FINANCIAL CREDITS ARE NOT NEARLY SO RESPONSIVE AS GOVERNMENT EXPORT-FINANCING AGENCIES TO PRESSURES FROM ORDER-SEEKING EXPORTERS.

7. RECESSION IN THE WEST HAS LIMITED POLAND'S HARD-CURRENCY EARNINGS, THUS INTENSIFYING ITS DEBT-SERVICING PROBLEM AT THE SAME TIME THAT INFLATION IN THE WEST HAS SHARPLY INCREASED THE PRICES OF IMPORTED CAPITAL GOODS.

8. A LITTLE OVER A YEAR AGO, POLISH OFFICIALS BEGAN TO REALIZE THAT IT WAS BECOMING INCREASINGLY DIFFICULT TO EITHER BORROW OR EARN THE FOREIGN EXCHANGE TO REPAY PREVIOUS BORROWINGS. POLISH PLANS TO BORROW IN THE WEST TO MODERNIZE POLAND'S INDUSTRY AND REPAY THE LOANS WITH INCREASED INDUSTRIAL EXPORTS WERE BEING HAMPERED BY THE DISRUPTION IN WESTERN ECONOMIES AND DECREASED AVAILABILITIES OF FINANCIAL CREDITS.

9. TO EASE ITS DEBT-SERVICING PROBLEMS, POLAND HAS
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EMBARKED ON A CAMPAIGN TO CUT IMPORTS AND FOSTER EXPORTS. WE KNOW OF REDUCTIONS OF SOME \$500-MILLION IN IMPORT-INTENSIVE INDUSTRIAL PROJECTS. HOWEVER, EVEN THE MOST OPTIMISTIC OBSERVERS FORESEE HARD-CURRENCY TRADE-AND-CURRENT-ACCOUNT DEFICITS THIS YEAR OF ABOUT \$2.0-BILLION. THEREFORE, DURING 1976, IN ORDER TO PAY THE \$1.5-BILLION DEBT SERVICE, POLAND WILL HAVE TO SECURE FINANCING TOTALING THAT MUCH MORE THAN ITS CURRENT-ACCOUNT DEFICIT, OR A TOTAL OF ABOUT \$3.5-BILLION. IT IS ASSUMED THAT POLAND DOES NOT MAINTAIN SIZEABLE FOREIGN-EXCHANGE RESERVES; THEREFORE, THESE COULD BE DRAWN DOWN ONLY SLIGHTLY TO MEET JUST A SMALL PART OF THE 1976 DEBT-SERVICE REQUIREMENTS.

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ACTION INR-07

INFO OCT-01 EUR-12 EA-07 IO-11 ISO-00 SP-02 USIA-06 AID-05

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AGR-05 /114 W

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R 130803Z MAR 76

FM AMEMBASSY WARSAW

TO SECSTATE WASHDC 232

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AMEMBASSY BERN

AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY BUCHAREST

AMEMBASSY BUDAPEST

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10. UNTIL IT CAN BRING ITS HARD-CURRENCY ACCOUNTS INTO BETTER BALANCE, POLAND WILL HAVE TO SEEK ALL KINDS OF FINANCING TO MEET ITS DEBT-SERVICE OBLIGATIONS. THE MOST DESIRABLE LOANS FROM POLAND'S POINT OF VIEW WOULD BE STRAIGHT FINANCIAL CREDITS, SUCH AS THE RECENT \$45 AND \$50 MILLION PLACEMENTS FOR BANK PKO AND BANK HANDLOWY AND THE 5-MILLION KUWAITI DINAR NOTE ISSUE BY KUWAIT. THIS TYPE OF LOAN, HOWEVER, IS BECOMING VERY DIFFICULT TO SECURE. OTHER FORMS OF FINANCING BEING SOUGHT ARE PSEUDO-PROJECT LOANS FOR COAL AND COPPER DEVELOPMENT LOANS IN EXCHANGE FOR GUARANTEES OF FUTURE DELIVERIES OF CERTAIN TONNAGES OF COAL, THREE-YEAR LOANS FOR GRAIN IMPORTS, AND ONE TO THREE-YEAR LOANS FOR IMPORTS OF OTHER CONSUMPTION ITEMS.

11. ANY BORROWING WHICH PROVIDES FREELY USABLE FOREIGN EXCHANGE AND DOES NOT FINANCE IMPORTS, OR WHICH FINANCES IMPORTS WHICH OTHERWISE WOULD HAVE BEEN PAID FOR ON A CASH BASIS, IS PARTICULARLY HELPFUL. EXPORTER CREDITS FOR NEW INVESTMENT PROJECTS DO NOT PROVIDE ANY FREE FUNDS TO USE FOR DEBT-SERVICE PAYMENTS. MOREOVER, SINCE SUCH CREDITS NORMALLY REQUIRE A 10 TO 20 PERCENT DOWN PAYMENT, ACCEPTING THEM ONLY INTENSIFIES POLAND'S CASH-FLOW PROBLEMS.

12. POLAND'S HARD-CURRENCY DEBT PROBLEM RESULTED FROM ITS ENERGETIC MOVES TO INCREASE ITS ECONOMIC TIES WITH THE WEST, AND MANY OF ITS EFFORTS TO DEAL WITH THAT PROBLEM ARE FURTHER INTENSIFYING THOSE TIES. BECAUSE OF ITS FINANCIAL PINCH, POLAND CANNOT TAKE ANY IMPORTANT ECONOMIC MOVE WITHOUT BEING CONCERNED ABOUT HOW IT WILL BE INTERPRETED IN THE FINANCIAL CIRCLES OF NEW YORK, LONDON, AND FRANKFURT. IN ADDITION, THOSE POLISH OFFICIALS WHO HAVE HAD THE GREATEST EXPERIENCE WITH THE WEST AND ARE PROBABLY THE MOST FAVORABLY INCLINED TOWARD IT, ARE HAVING THEIR AUTHORITY AUGMENTED AS POLAND INCREASINGLY HAS TO RELY ON THEIR EXPERTISE TO KEEP WESTERN CREDITORS HAPPY.

13. MANY DEVICES ARE BEING USED TO ATTRACT LARGER NUMBERS OF WESTERN TOURISTS TO POLAND, AND THE POLISH PRIVATE SECTOR IS BEING GIVEN INCENTIVES TO PROVIDE SERVICES FOR THESE TOURISTS. THE LOCAL PRIVATE SECTOR IS ALSO BEING ENCOURAGED TO STEP UP PRODUCTION OF GOODS AND SERVICES
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FOR LOCAL CONSUMERS. THE INTENT APPEARS TO BE TO INCREASE PRODUCTION SO AS TO KEEP POLISH CONSUMERS HAPPY WHILE LARGER AMOUNTS OF SOME GOODS ARE BEING TAKEN OUT OF THE LOCAL MARKET TO EARN FOREIGN EXCHANGE THROUGH EXPORTS AND

TOURISM.

14. THERE ARE ALSO CLEAR SIGNS THAT THE COUNTRY'S NEED TO EARN FOREIGN EXCHANGE AND ITS DIMINISHED BORROWING CAPACITY MAY CAUSE IT TO REVERSE ITS PRESENT POLICY AND PERMIT JOINT-EQUITY VENTURES IN POLAND. THE U.S. GROUP OF PORAY, TURNER CONSTRUCTION, AND HILTON HOTELS HAS BEEN TOLD THAT FULL GOVERNMENT APPROVAL HAS BEEN GRANTED TO CONSTRUCT AND OPERATE LOT'S PROPOSED OFFICE/HOTEL BUILDING AS A JOINT VENTURE WITH A FOREIGN PARTNER OR PARTNERS. OTHER JOINT-VENTURE POSSIBILITIES MAY BE IN THE OFFING ONCE THE FIRST ONE IS AGREED UPON.

15. ON THE POLITICAL SIDE, IT IS ALSO CLEAR THAT THE NEED FOR THE GRANT AND LOW-INTEREST LOAN WHICH THE FRG OFFERED MUST HAVE PLAYED A BIG ROLE IN MAKING THE POLISH GOVERNMENT MORE FORTHCOMING ON THE EMIGRATION ISSUE THAN IT MIGHT OTHERWISE HAVE BEEN.

16. THE EMBASSY'S VERY ROUGH ESTIMATE IS THAT POLAND STILL IS SHORT BY SEVERAL HUNDRED MILLION DOLLARS IN MEETING ITS 1976 DEBT-SERVICE PAYMENTS. THIS GAP COULD BE FILLED BY FINDING NEW EXPORTS, BY REDUCING PROMPTLY PAID IMPORTS, OR BY FURTHER FINANCIAL OR QUASI-FINANCIAL CREDITS. IT WILL TAKE SOME EFFORT IN THE COMING MONTHS, BUT THIS GAP SHOULD BE FILLED. NEXT YEAR, POLAND WILL FACE SUBSTANTIALLY HIGHER DEBT-SERVICING PAYMENTS. UNLESS THE WESTERN ECONOMIES ARE MUCH MORE WILLING TO RECEIVE POLISH EXPORTS NEXT YEAR OR THERE IS A MAJOR RELAXATION OF INTERNATIONAL CREDIT MARKETS, POLITICALLY UNPALATABLE RESTRICTIONS ON IMPORTS AND DOMESTIC CONSUMPTION MAY BE REQUIRED TO MEET 1977'S DEBT SERVICE. MUCH OF THE FINANCING POLAND WILL BE SEEKING FROM WESTERN CREDITORS WILL SERVE TO ROLL OVER EXISTING DEBT.

17. POLAND HAS BEEN SEEKING FINANCIAL ASSISTANCE FROM THE MIDDLE EAST FOR SOME MONTHS. IT MUST BE DISAPPOINTED; ALL IT HAS SECURED SO FAR IS THE 5-MILLION KUWAITI DINAR NOTE
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ISSUE. ACCORDING TO BANKHANDLOWY SOURCES, MIDDLE EASTERN COUNTRIES HAVE BEEN PLACING SIZEABLE SHORT-TERM DEPOSITS WITH HANDLOWY, BUT HAVE BEEN RELUCTANT TO AGREE TO ANY LONGER-TERM ARRANGEMENTS.

18. GIVEN THE SOVIET UNION'S CURRENT ECONOMIC DIFFICULTIES, THERE IS LESS ASSURANCE AMONG BANKERS THAT THE SOVIETS ARE THE ULTIMATE GUARANTOR OF LOANS TO POLAND, AS WELL AS TO OTHER EASTERN EUROPEAN COUNTRIES. IT IS DIFFICULT TO JUDGE FROM HERE HOW MUCH THE SOVIETS WOULD BE WILLING TO DO TO HELP POLAND AVOID A FORMAL RESCHEDULING OF ITS DEBTS.

IF POLAND HAS TO SEEK RESCHEDULING, HOWEVER, WE BELIEVE WESTERN BANKERS WOULD BE QUITE WILLING TO ACCOMMODATE. POLAND IS PROUD OF ITS CREDIT RATING AND WOULD SEEK RESCHEDULING ONLY VERY RELUCTANTLY.

19. DESPITE ITS CURRENT FINANCIAL CRUNCH, POLAND REMAINS A VERY GOOD LONG-TERM CREDIT RISK AND IS RECOGNIZED AS SUCH BY MOST INTERNATIONAL BANKERS. THE VAST BULK OF ITS BORROWING HAS BEEN FOR WELL CONCEIVED INVESTMENT PROJECTS DESIGNED TO INCREASE THE COUNTRY'S PRODUCTIVE CAPACITY. THE SHORT-TERM FINANCIAL CRUNCH POLAND IS NOW FACING AS IT BUYS TIME UNTIL IT GETS ITS CURRENT ACCOUNTS INTO BETTER BALANCE IS HURTING THE COUNTRY'S CREDIT RATING. IT IS A VERY UNPLEASANT EXPERIENCE FOR POLAND'S ECONOMIC AND POLITICL LEADERS. THEY CAN BE EXPECTED TO MAKE A GREAT EFFORT TO END THIS SITUATION AS SOON AS POSSIBLE AND TO TAKE STEPS TO SEE THAT IT DOES NOT OCCUR AGAIN.
DAVIES

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Message Attributes

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